ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Pescetti	Analyst:	Marion Mann DeJong	Bill Number:	AB 572
Related Bills:	SB 93 (1999/00); AB 1469 (1997/98)	Telephone:	845-6979	Introduced Date:	02/19/1999
		Attorney:	Doug Bramhall	Sponsor:	

SUBJECT: Conformity to Roth IRA, Burden of Proof, Innocent Spouse & Disabled Taxpayers

SUMMARY

This bill would generally conform to the following four provisions of the Internal Revenue Service Restructuring and Reform Act of 1998.

- Changes relating to Roth individual retirement accounts (IRAs). (See Roth IRAs on page 2.)
- Shifting the burden of proof for factual issues in court proceedings if the taxpayer meets specified criteria. (See Burden of Proof on page 6.)
- Expansion of innocent spouse protections. (See Innocent Spouse on page 9.)
- Suspension of the statute of limitations (SOL) for certain refund claims for periods during which the taxpayer is "financially disabled." (See SOL/Financially Disabled Taxpayers on page 12.)

This bill would also shift the burden of proof from taxpayers to the Board of Equalization and the Employment Development Department. These provisions are not discussed in this analysis since they do not impact this department.

EFFECTIVE DATE

As a tax levy this bill would become effective immediately upon enactment; however, the operative dates of the specific provisions would vary, as discussed in the analysis.

LEGISLATIVE HISTORY

On July 22, 1998, President Clinton signed H.R. 2676, the Internal Revenue Service Restructuring and Reform Act of 1998 (IRS Reform Act). The IRS Reform Act provides for a massive reorganization of the way the IRS does business and creates a board of directors to help oversee the agency. The IRS Reform Act also provides various taxpayer protections (e.g., innocent spouse and disabled taxpayer relief) and instructs the IRS to promote and improve its electronic filing programs. Finally, the IRS Reform Act eliminates the 18-month holding period for long-term capital gains and contains several technical corrections to the Taxpayer Relief Act of 1997.

Board Position:			Department Director	Date
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______ N	______ OUA	X PENDING	**Gerald Goldberg**	**3/22/1999**

AB 1469 (1998) was amended to conform to selected parts of the IRS Reform Act and contained certain taxpayer rights provisions (but did not include the Burden of Proof provisions contained in this bill). The Governor vetoed AB 1469 because of another provision contained in that bill.

SUMMARY OF TAX REVENUE

The revenue impact of this bill, is estimated as follows:

Revenue Impact of AB572 Assumed Enactment After 06/30/1999 Fiscal Years Beginning 1999-2000 (In Millions)	
Provision	**Revenue Impact**
1. Roth IRA's	Minor Revenue Losses
2. Burden of Proof	Unknown Losses
3. Innocent Souse	Minor Revenue Losses of ($500,000) annually
4. SOL/Fin. Disabled Taxpayers	($1) Million annually
Total	**Unknown, but at least ($1.5) Million annually**

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

BOARD POSITION

Pending.

1. Roth IRAs

OPERATIVE DATE

This provision would be operative for taxable years beginning on or after January 1, 1999.

BACKGROUND

Beginning in 1998, **federal and California law** provide for a new type of IRA, called a Roth IRA. A Roth IRA differs from other IRAs in that the tax advantages are "backloaded." Contributions to a Roth IRA are not tax deductible. Instead, the IRA earnings (e.g., interest and dividends) are distributed tax free (provided that certain requirements are met). To be treated as a Roth IRA, the account must be designated as such when it is established. Unlike other IRAs, an individual may make contributions to a Roth IRA beyond the individual's age of 70½.

Distributions from a Roth IRA are not included in gross income and are not subject to the 10% early withdrawal tax if certain requirements are met. In addition to other requirements, the individual must have held the Roth IRA for a five-year period beginning with the first year in which a contribution was made to the Roth IRA and ending with the end of the fifth year after the contribution.

Additionally, holders of a Roth IRA do not need to start receiving distributions by the age of 70½, as do holders of other types of IRAs.

Federal and California law also permits the "rollover" of a non-Roth IRA into a Roth IRA if the taxpayer's AGI for the year does not exceed $100,000 (computed without regard to the rollover distribution) and the taxpayer is not a married individual filing a separate return. The $2,000 annual contribution limit does not apply to rollovers. The rollover of an ordinary IRA into a Roth IRA requires the taxpayer to report the ordinary IRA distribution in gross income. However, if the ordinary IRA is contributed to the new Roth IRA within 60 days of the distribution, the 10% early withdrawal tax will not apply. If an ordinary IRA is rolled into a Roth IRA before January 1, 1999, the amount that is includible in gross income is included ratably over a four-year period. The law permits a rollover into or between Roth IRAs more than one time a year.

LEGAL RULINGS

In 1998, Franchise Tax Board issued two legal rulings regarding Roth IRAs.

Legal Ruling 98-3 provides rules regarding the taxation of IRA distributions rolled over to a Roth IRA in 1998 followed by a change in residence status.

Legal Ruling 98-4 provides that for the 1998 taxable year, if a taxpayer makes a trustee-to-trustee transfer from a federally designated Roth IRA that recharacterizes contributions to the Roth IRA for federal purposes, such transfer shall be treated as designating the Roth IRA as a traditional IRA for California tax purposes. As a result, taxpayers that recharacterize a contribution to a Roth IRA will be treated the same for California purposes.

SPECIFIC FINDINGS

The **IRS Reform Act** made technical changes in the following seven areas of the Roth IRA provisions:

1. Early Withdrawals of Amounts Converted From Regular IRAs to Roth IRAs. Under the law before the IRS Reform Act, (1) the four-year income spread was mandatory, not elective, and (2) the 10% tax on early withdrawals did not apply to conversions of regular IRAs into Roth IRAs. Thus, under **federal law** before this change, taxpayers under age 59½ could escape the 10% early withdrawal penalty tax by rolling over funds from a regular IRA to a Roth IRA and then immediately thereafter taking a distribution from the Roth IRA.

The **IRS Reform Act** modifies the rules relating to conversions of regular IRAs into Roth IRAs in order to prevent taxpayers from receiving premature distributions from a Roth Conversion IRA while retaining the benefits of the four-year income spread as follows:

- Acceleration of income inclusion. Where amounts are converted in 1998, and are thus subject to the four-year income spread, income inclusion is accelerated for any amounts withdrawn before 2001, the fourth year of the spread. This is done by adding the amount withdrawn in that year to the amount required to be included in income in that year under the four-year income spread rule. However, a limitation to the inclusion rule is provided to prevent more than the total amount required to be included in income over the four-year period from being included in income.

- Election. The **IRS Reform Act** makes the four-year income spread elective. Once made, the election or non-election cannot be changed.

- Application of early withdrawal tax to converted amounts. If converted amounts are withdrawn within the five-year period beginning with the year of the conversion, the amount withdrawn, only to the extent attributable to amounts that were includible in income due to the conversion, will be subject to the 10% early withdrawal tax.

2. Determination of Five-Year Holding Period. Under the law before the IRS Reform Act change, the five-year holding period with respect to conversion of Roth IRAs began with the tax year of the conversion.

- Applying the five-year holding period for Roth IRAs. The **IRS Reform Act** eliminates the special rule under which a separate five-year holding period begins for purposes of determining whether a distribution of amounts attributable to a conversion is a qualified distribution. Thus, the five-year holding period rule for Roth IRAs will begin with the year for which a contribution is first made to a Roth IRA. A subsequent conversion will not start the running of a new five-year period.

- Return of excess contributions. Distributions of excess contributions and earnings allocable to the contributions are not considered qualified distributions.

- Ordering rules. Ordering rules are provided to determine which amounts are withdrawn in the event a Roth IRA contains both conversion amounts (possibly from different years) and other contributions. Under these rules, regular Roth IRA contributions will be deemed to be withdrawn first, then converted amounts (starting with the amounts first converted). Withdrawals of converted amounts will be treated as coming first from converted amounts that were includible in income. Earnings will continue to be treated as withdrawn after contributions. For purposes of these rules, all Roth IRAs (regardless of whether maintained in separate accounts) are considered a single Roth IRA.

3. Corrections of Erroneous Conversions. Under the law before the IRS Reform Act change, no mechanism allowed a taxpayer to correct or “undo” an erroneous conversion, such as when a taxpayer makes a conversion early in a tax year and then discovers by the end of the year that the AGI limit of $100,000 has been exceeded and, thus, the taxpayer is ineligible to make the conversion.

The **IRS Reform Act** provides that contributions to an IRA and earnings on those contributions may be transferred in a trustee-to-trustee transfer from any IRA to another IRA by the due date for the taxpayer’s return for the year of the contribution (including extensions). Any transferred contributions will be recharacterized and treated as if contributed to the transferee IRA and not to the transferor IRA. Any transfer of contributions must be accompanied by any net income allocable to the contributions. Also, these transfers are permitted only if no deduction was allowed with respect to the contribution to the transferor plan. These provisions are effective for tax years beginning after December 31, 1997.

4. Effect of Account Holder’s Death during Four-Year Spread Period.

The **IRS Reform Act** provides that any amounts remaining to be included in income as a result of a 1998 conversion (the four-year spread) will be includible in income on the final return of the deceased taxpayer. If the surviving spouse is the sole beneficiary of the Roth IRA, the spouse may elect to continue the deferral by including the remaining amounts in his or her income over the remainder of the four-year period. However, that election may not be made or changed after the due date for the spouse's tax year that includes the date of death.

5. Determination of AGI Limit for Conversions. The **IRS Reform Act** provides that AGI, for purposes of applying the $100,000 threshold, is determined in the same manner as for regular IRAs. For regular IRAs, AGI includes taxable social security and railroad retirement benefits and the application of the passive activity loss rules. However, the exclusions for interest on U.S. savings bonds used to pay higher education expenses, for employer-provided adoption assistance programs, and for foreign earned income are not taken into account in determining AGI. In addition, the deduction for a contribution to a regular IRA is not taken into account.

The **IRS Reform Act** also makes it clear that the applicable AGI is the AGI for the year of the distribution to which the conversion relates. It also clarifies that, for purposes of computing taxable income, the conversion amount is to be taken into account in computing all AGI-based phase-out amounts except for the modified AGI amount used in Roth IRA conversions.

6. Clarification of Phase-out Range. The $2,000 Roth IRA maximum contribution limit is phased out for individual taxpayers with AGI between $95,000 and $110,000 and for married taxpayers filing a joint return with AGI between $150,000 and $160,000. The **IRS Reform Act clarifies** that the phase-out range for the Roth IRA maximum contribution limit for a married individual filing a separate return is $0 to $10,000 of AGI.

7. Clarification of Contribution Limit. The **IRS Reform Act** clarifies that the maximum amount of contributions an individual may make to all of his or her IRAs is limited to a cumulative total of $2,000 per year.

The **IRS Reform Act** also provides that a simplified employee pension (SEP) or a SIMPLE IRA may not be designated as a Roth IRA and contributions to a SEP or SIMPLE IRA cannot be taken into account for purposes of the $2,000 contribution limit. Thus, contributions to a SEP or SIMPLE IRA will not affect the amount that an individual can contribute to a Roth IRA.

All provisions contained in the IRS Reform Act that affect Roth IRAs have an operative date for federal law for tax years beginning after December 31, 1997.

California law is in conformity with federal law as it relates to Roth IRAs prior to the enactment of the IRS Reform Act. Additionally, California law provides that the early withdrawal tax applied to converted amounts withdrawn within the five-year period beginning with the year of conversion.

This provision would conform to the IRS Reform Act technical changes relating to Roth IRA provisions discussed above.

Implementation Considerations

This provision would be operative for taxable years beginning on or after January 1, 1999, while the federal provision was operative for taxable years beginning on or after January 1, 1998. Thus, taxpayers who chose not to elect to spread the conversion amount over four years for federal purposes would still be required to spread the conversion amount over four years for state purposes, creating a state and federal difference for four years. In fact, since the taxpayer would not be allowed to make a state election, the language related to the election in the bill indicating a federal election for 100% inclusion in 1998 would be binding for California tax purposes could cause taxpayer confusion.

Technical Considerations

Amendments 1 through 8 would make minor technical changes.

FISCAL IMPACT

Departmental Costs

This provision would not significantly impact the department's costs.

Tax Revenue Estimate

This bill would conform to several changes made in federal law that, for the most part, are technical and would affect a relatively small number of taxpayers. Some of the changes would result in revenue gains while others would result in revenue losses. Thus, it is expected that conforming to the federal changes would result in unknown, but minor net impacts on state revenue.

2. Burden of Proof

OPERATIVE DATE

This provision would be operative on the date of enactment.

SPECIFIC FINDINGS

Under federal law, taxpayers are required to keep certain records and may be requested by the IRS to substantiate items reflected on their federal income tax returns. The IRS may issue a deficiency assessment based on taxpayers' inability to substantiate items reflected on their income tax return or third-party information returns (W-2s, 1099s, etc.). If collection is determined by IRS to be in jeopardy, a jeopardy assessment is issued, whereby the amount of the deficiency is immediately due and payable.

Taxpayers may protest deficiency assessments or jeopardy assessments to the IRS. In the event the IRS denies the protest, under the federal appeals system, the taxpayer may either: (1) appeal the assessment to the Tax Court, or (2) pay the assessment and file a claim for refund with the IRS. Once the claim is denied (or no action is taken by the IRS within six months), the taxpayer may file suit for refund in U.S. District Court or the U.S. Court of Claims.

In these reviews, a rebuttable presumption exists that the IRS's determination of tax liability is correct. Taxpayers have the burden of proving that the IRS's action was incorrect and establishing the merits of their claims by a preponderance of the evidence. This review is an independent judicial review by a trial court upon evidence submitted by the parties. Both the taxpayer and the IRS can bring actions in appellate courts to appeal final adverse determinations, except small claims division determinations, which are binding.

The IRS Reform Act shifts the burden of proof to the IRS in any court proceeding for factual issues if the taxpayer introduces credible evidence with respect to factual issues. This change applies to income, estate, gift and generation-skipping transfer taxes. For the burden of proof to shift, the taxpayer must:

- substantiate any item;
- keep records;
- cooperate with the IRS (according to the federal conference report, this includes exhausting the taxpayer's administrative remedies, including any appeal rights provided by the IRS);
- meet the net worth limitations ($7 million) if not an individual taxpayer.

The burden of proof also shifts to the IRS (1) when the IRS adjusts income through the use of statistical information on unrelated taxpayers and (2) for penalties or when additions to tax are imposed.

Under current state law, all taxpayers may be requested by the FTB to furnish substantiation of the items reflected on their income tax returns and certain taxpayers (i.e., water's-edge taxpayers) may be required to keep certain records. The FTB may issue a proposed deficiency assessment based on: taxpayers' inability to substantiate items reflected on their income tax return, third-party information returns (W-2s, 1099s, etc.), or information FTB receives from IRS. In the rare instance that collection is determined by FTB to be in jeopardy, a jeopardy assessment is issued whereby the amount of the deficiency is immediately due and payable.

If the taxpayer disputes an assessment, the taxpayer's administrative remedies allow the taxpayer to either (1) protest the proposed deficiency assessment or jeopardy assessment by filing a written "protest" with the FTB, or (2) pay the assessment and file a claim for refund. If the claim is denied or no action is taken on the claim within six months the taxpayer may further pursue an administrative remedy by an appeal to the BOE or initiate legal action for a refund in superior court. Throughout the administrative remedy process, the burden of proof to establish that the FTB determination is incorrect is on the taxpayer.

In the event of a final adverse BOE decision on appeal, or in the event of filing a legal action in superior court directly as a result of a refund claim denial, the taxpayer's recourse is to pay the amount asserted to be due and bring an action for refund against the state in superior court. With residency matters payment is not required. In litigation, as with administrative appeals, there is a rebuttable presumption that the FTB action was correct.

In addition, a taxpayer in a suit for refund is the plaintiff. Consequently, taxpayers (like plaintiffs in other civil actions) have the burden of proving that the FTB's action was incorrect and establishing the merits of their claims by a preponderance of the evidence.

Under current state law, FTB may have the burden of proving the correctness of an assessment based upon third-party information (e.g., W-2 or 1099) if the taxpayer files an appeal with the BOE on the basis that the assessment is incorrect. The burden shifts to FTB if the taxpayer sets forth a reasonable argument regarding the disputed income, appeals FTB's action and fully cooperates with FTB.

This bill would shift the burden of proof for factual issues in court proceedings from the taxpayer to FTB. For the burden of proof to shift, the taxpayer must:

- introduce credible evidence with respect to factual issues relevant to determining the liability of the taxpayer;
- keep records; and
- cooperate with the FTB's requests for witnesses, information, documents, meeting, and interviews.

The burden of proof would also shift to the FTB when penalties or additions to tax are imposed.

Policy Considerations

This bill would raise the following policy considerations.

- The burden of proof provision of this bill does not completely conform to the federal law. This bill does not: (1) limit the burden of proof shift to the smaller taxpayers, (2) define what is considered taxpayer "cooperation," or (3) limit the provision to court proceedings arising in connection with "examinations" commencing after the date of enactment.

- Generally, in civil cases the burden of proof is on the plaintiff, the party seeking corrective action. The taxpayer is the plaintiff in all California superior court actions for refund and to determine residence. In addition, for tax cases the taxpayer has control of the records and documents necessary to ascertain the taxpayer's tax liability.

- Taxpayers may find that the federal provision does not provide a significant benefit due to the mechanics of when and how the burden of proof shifts from the taxpayer. Further, taxpayers, misunderstanding the burden of proof provision, could fail to keep necessary documents.

Implementation

This bill would raise the following implementation considerations. Department staff is available to assist the author with any necessary amendments.

- This bill could require FTB to engage in more extensive evidentiary gathering activities. Additional legal staff may be needed. Shifting the burden of proof to the department may require longer retention of records and increased costs for storage.

- Under current law, FTB is not authorized to require most taxpayers to keep any records (books, papers, writings etc.), statements, returns or other information appropriate to determine the correct amount of tax reported on a tax return. To properly conform to the burden of proof provisions, legislation would also be needed to conform to the federal record-keeping requirements.

- It is unclear whether the department would have the burden of proof for issues resulting from federal changes.

Technical Considerations

The burden of proof provisions are structured awkwardly. The structure of the bill makes it appear that the taxpayer must meet four conditions for the burden of proof to shift (must meet subdivisions (a) through (d)). However, only subdivisions (a) and (b) contain the conditions. Subdivision (c) states that the section shall not be construed to override a requirement to substantiate any item and subdivision (d) places the burden of proof for penalties, additions to tax and other additional amounts with FTB.

FISCAL IMPACT

Departmental Costs

The departmental costs associated with this provision are unknown. The costs could increase, however, to the extent that additional supporting evidence would be required on all cases to support the state's position on any potential litigation cases.

Tax Revenue Estimate

The revenue loss for this provision would be determined by those assessments that may be revised due to incomplete documentation to support the assessment and revenues lost from possible negative effects on voluntary compliance.

Revenue losses in any given year are unknown. It is not possible to determine the number of cases in which the outcome would be changed because of the shift in the burden of proof. It is not clear how the courts would define "taxpayer cooperation."

3. Innocent Spouse

OPERATIVE DATE

This provision would apply to any liability for tax arising after the effective date of this bill and any liability for tax arising on or before the effective date, but remaining unpaid, as of that date.

SPECIFIC FINDINGS

Under prior federal law, spouses who filed a joint tax return were each fully responsible for the accuracy of the return and for the full tax liability (joint and several liability).

Prior federal law provided relief from liability for tax, interest and/or penalties for "innocent spouses." To qualify for innocent spouse relief, the innocent spouse was required to establish that:

- A joint return was made;
- An understatement of tax, which exceeded the greater of $500 or a specified percentage of the innocent spouse's adjusted gross income (AGI) for the most recent year, was attributable to a "grossly erroneous" item of the other spouse;
- In signing the return, the innocent spouse did not know, and had no reason to know, that there was an understatement of tax; and
- It was inequitable to hold the innocent spouse liable for the deficiency in tax.

The specified percentage of AGI was 10% if AGI was $20,000 or less. Otherwise the specified percentage was 25%. Grossly erroneous items include items of gross income omitted from reported income and claims of deductions, credits or basis in an amount for which there is no basis in fact or law.

Current federal law also provides relief for innocent spouses with respect to community property income not included on the separate return of a married person.

The IRS Reform Act makes innocent spouse status easier to obtain by eliminating all understatement thresholds and by requiring only that the understatement of tax be attributable to an erroneous item of the other spouse. Relief may be provided on an apportioned basis. An innocent spouse may be relieved of liability for the portion of an understatement of tax if the spouse did not know or have reason to know of the understatement of tax and it would be inequitable to hold the taxpayer (spouse) responsible for the deficiency.

The IRS Reform Act provides a separate liability election for a taxpayer who, at the time of the election, is no longer married to, is legally separated from, or for at least 12 months has been living apart from the spouse. The taxpayer has two years from the date the IRS begins collection action to make this election. The IRS Reform Act provides that the Tax Court has jurisdiction over disputes arising from the separate liability election. The IRS Reform Act requires the IRS to notify all taxpayers who have filed a joint return of their right to elect separate liability.

The IRS Reform Act expanded the relief provided for married persons filing separate returns to include relief for unpaid tax or any deficiency relating to the separate return that did not qualify for relief under current law.

Under current state law, as with prior federal law, spouses who file a joint tax return are each fully responsible for the accuracy of the return and for the full tax liability (joint and several liability).

Current state law also provides relief from liability for tax, interest and/or penalties for "innocent spouses" if it is inequitable to hold that spouse liable for the understatement. To qualify for innocent spouse relief, the innocent spouse must have filed a joint tax return and did not know, or had no reason to know, of the understatement. The spouse must be innocent with respect to the entire understatement.

Current state law, as with prior federal law, also provides relief for innocent spouses with respect to community property income not included on the separate return of a married person.

Current state law, in the case where the self-assessed tax has not been fully paid, requires FTB to provide the other spouse with 30 days notice of any determination to provide relief to the innocent spouse so that the other spouse may appeal the determination.

This provision would conform, with modifications, state law to the innocent spouse provisions of the IRS Reform Act, including the separate liability election. Modifications to the IRS Reform Act would (1) send appeals of FTB innocent spouse determinations to the BOE rather than Tax Court and (2) expand the provision requiring FTB to provide 30-day notice to the other spouse to apply to assessments as well as underpaid self-assessed tax so that the other spouse may appeal an innocent spouse determination.

Under this provision, pursuant to procedures prescribed by FTB, equitable relief can be granted to an innocent spouse as the facts and circumstances warrant.

Policy Considerations

This provision would allow individuals to obtain relief even though they might have been the primary beneficiary or person in control of the household income, though not the person earning the income. However, this is mitigated to some extent since the election would be invalid if FTB demonstrates that the assets were transferred as part of a fraudulent scheme to avoid taxes or the department demonstrates that the individual making the election had actual knowledge at the time the return was filed.

Implementation Considerations

Collections Bureau staff is already experiencing a slight increase in workload because of the federal provision and expects an even greater impact from this provision since more taxpayers would qualify for innocent spouse relief. Further, due to the complex nature of questions regarding this issue, any calls would be referred to staff in the Collections Bureau with expertise in this area. The taxpayer information (TI) computer system would need modification to issue separate notices and maintain separate but equal liabilities. To the extent information may need to be retained on the collection system, this provision would impact the new personal income tax collection system (ARCS) design and/or strategies.

FISCAL IMPACT

Departmental Costs

The department's costs to administer this provision are preliminary. It is estimated that the costs would range from $598,000 to $798,000 for the first year and $176,000 annually thereafter. The majority of the first-year cost ($400,000 to $600,000) would be required to program and test changes to the TI system. The remaining first-year and ongoing costs would be required to increase Collection Bureau staff (three senior compliance representative positions).

Tax Revenue Estimate

Current law provides innocent spouse relief under certain circumstances. The incremental impact of conforming to proportionate liability would result in minor revenue losses, on the order of $500,000 annually.

4. SOL/Financially Disabled Taxpayers

OPERATIVE DATE

This provision would apply to all periods of disability before, on or after the effective date of this bill. However, it would not apply to any claim barred by the SOL as of the effective date.

SPECIFIC FINDINGS

Current federal law requires a taxpayer to file a claim for refund within three years of the filing of the return or within two years of the payment of tax, whichever period expires later (if no return is filed the two-year limit applies). A refund claim that is not filed within these time periods is rejected as untimely.

The IRS Reform Act suspends the SOL for certain refund claims for a period where the taxpayer is "financially disabled." Individuals are "financially disabled" if they are unable to manage their financial affairs because of a medically determinable physical or mental impairment that is expected to result in death or to last for a continuous period of at least one year. An individual would not be financially disabled for any period that the individual's spouse or any other person is legally authorized to act on that individual's behalf in financial matters.

Current state law requires a taxpayer to file a claim for refund within four years from the due date (without regard to extensions) or one year from the date of payment of tax, whichever is later. In the case of a California waiver of the SOL, the period for filing a claim for refund is the period of the waiver or one year from the date of overpayment, whichever is later. In the case of a federal waiver, the period for filing a claim for refund is six months from the expiration of the federal waiver.

Current state law requires the taxpayer to notify FTB if the amount of gross income or deductions reported to the IRS for any year is changed, either by the taxpayer or federal authorities.

The taxpayer has six months from the final federal determination date to report the change to FTB. Claims for refund must be filed within two years from the date of the final federal determination.

Current state law allows taxpayers to file a claim for refund up to seven years after the due date of the return in the case of bad debts, worthless securities or erroneous inclusion of recoveries.

This provision would conform state law to the IRS Reform Act provisions to suspend the SOL for certain refund claims when the taxpayer is "financially disabled."

Implementation Considerations

Implementation of this provision would occur during the department's normal annual system update.

FISCAL IMPACT

Departmental Costs

This provision would not significantly impact the department's costs.

Tax Revenue Estimate

Revenue losses from additional refunds issued would be on the order of $1 million annually based on federal projections.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 572
As Introduced February 19, 1999

AMENDMENT 1

On page 5, modify lines 17 and 18 as follows:

Code, ~~as amended by Public Law 105-206,~~ shall apply to those distributions for state purposes, ~~except that~~ no

AMENDMENT 2

On page 5, modify lines 32 and 33 as follows:

Internal Revenue Code~~, as amended by Public Law 105-206,~~ shall be increased by the aggregate distributions

AMENDMENT 3

On page 6, modify lines 1 and 2 as follows:

408A(d)(3)(A)(iii) of the Internal Revenue Code~~, as amended by Public Law 105-206,~~ shall not exceed the

AMENDMENT 4

On page 6, modify line 5 as follows:

Revenue Code~~, as amended by Public Law 105-206,~~ for all

AMENDMENT 5

On page 6, modify lines 11 and 12 as follows:

Internal Revenue Code~~, as amended by Public Law 105-206,~~ dies before all the amounts are included, all

AMENDMENT 6

On page 6, line 35, strikeout "includable" and insert:

includible

AMENDMENT 7

On page 7, strikeout lines 10 through 12, inclusive, and insert:

been includible, no election under this paragraph shall be allowed for state

AMENDMENT 8

On page 8, modify lines 17 and 18 as follows:

(h) (1) Except as provided by <u>the Secretary of the Treasury (unless</u> the Franchise Tax Board <u>provides otherwise)</u>, if, on or before the due date for any taxable year,